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IN THE

Supreme Court of the United States

No. 212

WILLIAM R. THORSEN,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR THE WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

EDWIN H. CASSELS,
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THE GUNTHORP-WARREN PRINTING COMPANY, 210 WEST JACKSON, CHICAGO

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COMMISSIONER OF INTERNAL REVENUE,
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PETITION FOR THE WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

MAY IT PLEASE THE COURT:

The petition of William R. Thorsen respectfully shows to this Honorable Court:

A.

The Commissioner of Internal Revenue, on March 6, 1928, found a deficiency of $36,720.96 in the income tax for the calendar year 1923 of the petitioner herein, William R. Thorsen, of San Francisco, California. On May 2, 1928, Thorsen filed in the United States Board of Tax Appeals his petition for a review of the finding of the Commissioner.

On November 25, 1927, the Commissioner of Internal Revenue had found a deficiency of $9,243.66 in the income tax for the calendar year 1923 of Charles J. Canfield, of Chicago, Illinois. On Janu-

ary 20, 1928, Canfield had filed in the United States Board of Tax Appeals his petition for a review of such finding of the Commissioner.

Both Thorsen and Canfield were stockholders in West Side Lumber Company and the additional tax in each case was a surtax assessed on account of the receipt by each of his share of a dividend paid by that company in 1923.

The two cases were consolidated for hearing befor the Board of Tax Appeals and heard together as one case.

Thereafter (after a review of a previous divisional opinion) on October 27, 1931, the final decision of the Board in the two cases was promulgated with but one set of findings of fact and one opinion, sustaining (with conceded corrections) the findings of the Commissioner in the two cases, seven of the then fifteen members of the Board dissenting. (*Canfield* v. *Commissioner; Thorsen* v. *Commissioner,* 24 B. T. A. 480.)

Thereafter, on February 1, 1932, Canfield filed his petition for a review of so much of the decision of the Board as affected his tax, by the Circuit Court of Appeals for the Seventh Circuit. That court on January 13, 1933, *reversed* the decision of the Board of Tax Appeals so far as it affected Canfield, the issue (one entirely of law) upon his petition being identical with that presented in the case of Thorsen. (*Canfield* v. *Commissioner,* 62 Fed. (2d) 751.)

On April 16, 1932, Thorsen filed in the Circuit Court of Appeals of the Ninth Circuit his petition for a review of the same decision of the Board as far as it affected his tax.

The Circuit Court of Appeals of the Ninth Cir-

cuit, on May 19, 1933, *affirmed* the decision of the Board of Tax Appeals. Thorsen now files herein his petition for the writ of certiorari to review this decision, which is squarely in conflict with that of the Circuit Court of Appeals of the Seventh Circuit on indentically the same question of law.

In the meantime, in an opinion prepared before the decision of the Circuit Court of Appeals of the Seventh Circuit, the Board of Tax Appeals itself in *Walker* v. *Commissioner,* 24 B. T. A. ...., involving this same point, handed down an opinion contrary to its prior opinion in the Canfield and Thorsen cases and in accord with the decision of the Circuit Court of Appeals of the Seventh Circuit in the Canfield case. The Board, since the decision in the Thorsen case, has refused to reconsider its decision in the Walker case, although Walker is a resident of the Ninth Circuit.

THE ISSUE.

All the facts were stipulated. The only question is one of law.

Canfield and Thorsen were both stockholders in West Side Lumber Company, a corporation, which on March 1, 1913, had a paid-in capital of $1,500,000 and a surplus of $4,332,684.78. Its earnings and losses after that date were:

Year Ending	Profits	Losses
February 28, 1914	$ 4,594.62	
February 28, 1915		$193,139.67
February 29, 1916		211,707.32
February 28, 1917	60,495.56	
February 28, 1918	57,901.55	
February 28, 1919	208,737.34	
February 29, 1920	543,490.33	
February 28, 1921	640,837.43	
February 28, 1922	182,954.63	
February 28, 1923	718,858.29	
March 1, 1923 to April 14, 1923 (44/366 of $311,209.54)	37,413.17	
	$2,455,282.92	$404,846.99

The net of its operations for the period March 1, 1913, to April 14, 1923, was thus $2,050,435.93. During the years 1918 to April 1923, West Side Lumber Company had distributed $1,290,000 of this amount in dividends. The undistributed net balance as of April 14, 1923, from such operations was therefore $760,435.93. On that date, it paid a further dividend of $5,100,000, or $340 per share, to its stock-

holders, among them Canfield and Thorsen. The question is, what portion of this distribution was taxable and what portion was non-taxable under the provisions of Section 201 of the Internal Revenue Act of 1921, which reads as follows:

> "SEC. 201. (a) That the term 'dividend' when used in this title (except in paragraph (10) of subdivision (a) of Section 234 and paragraph (4) of subdivision (a) of Section 245) means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, except a distribution made by a personal service corporation out of earnings or profits accumulated since December 31, 1917, and prior to January 1, 1922.
>
> (b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. If any such tax-free distribution has been made, the distributee shall not be allowed as a deduction from gross income any loss sustained from the sale or other disposition of his stock or shares unless, and then only to the extent, that the basis provided in Section 202 exceeds the sum of (1) the amount realized from the sale or other disposition of such stock or shares, and (2) the aggregate amount of such distributions received by him thereon."

The petitioner contends that the "earnings or profits *accumulated* since February 28, 1913," nec-

essarily mean the *net* earnings or profits of the period from March 1, 1913, to the date of the dividend distribution. The Commissioner does not agree with this interpretation. He contends that the statute contemplates the distribution, first, of the net earnings of the last year of the period, then the earnings of the next to the last year, and so on backward, until losses are encountered in any given year. Then, he considers, such losses are to be applied against earnings of years antedating such losses and, if need be, against the surplus of March 1, 1913.

The net effect of these different interpretations, as applied to the facts of the Canfield and Thorsen cases, is that the Commissioner thus excludes the losses of $404,846.99 from the reckoning, in determining the "earnings accumulated since February 28, 1913," (excepting as they are used to absorb the profit of $4,594.62 for the year ending February 28, 1913), and considers only the accumulated successive profits of the period *March 1, 1916,* to April 14, 1923. The petitioner insists that such losses of $404,846.99 cannot be thus excluded from the reckoning, and that the net "earnings accumulated since February 28, 1913" were $2,050,435.93—of which $760,435.93 was on hand and undistributed on April 14, 1923, and hence was taxable to the stockholders who received it. The Commissioner by his method arrived at the figure of $1,160,658.30 as the undistributed earnings on April 14, 1923, "accumulated since February 28, 1913" and held this amount to be taxable to the several recipients.

Thorsen made his return upon the theory that he was taxable only with respect to his share of the net of operations of West Side Lumber Company from March 1, 1913, to April 14, 1923, as those figures were

given to him at the time he made his return. An audit of its books lessened the amount of such net to such an extent that if his interpretation of Section 201 be correct, he is entitled to a refund. If the Commissioner be right, there is a tax deficiency for 1923 of $27,131.69.

B.

REASONS RELIED UPON FOR THE ALLOWANCE OF THE WRIT.

1. The decision of the Court of Appeals of the Ninth Circuit is in direct conflict with the decision of the Circuit Court of Appeals of the Seventh Circuit in the case of *Charles J. Canfield* v. *Commissioner of Internal Revenue* (62 Fed. 2d. 751). It is also in conflict with the decision of the Circuit Court of Appeals of the Second Circuit in the case of *T. Irving Hadden, Executor* v. *Commissioner* (49 Fed. 2d. 709).

2. The Circuit Court of Appeals of the Ninth Circuit has herein decided an important question of federal law which has not been, but should be, settled by this court.

3. The Circuit Court of Appeals of the Ninth Circuit has herein decided a federal question in a way probably in conflict with applicable decisions of this court.

WHEREFORE your petitioner respectfully prays that the writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the Circuit Court of Appeals of the Ninth Circuit, commanding that court to certify and to send to this

court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, Number 6838, William R. Thorsen, Petitioner, *vs.* Commissioner of Internal Revenue, Respondent, and that the said judgment of the Circuit Court of Appeals for the Ninth Circuit may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

WILLIAM R. THORSEN,

EDWIN H. CASSELS,
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BARRY GILBERT,
ADOLPHUS E. GRAUPNER,
Of Counsel.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1932.

WILLIAM R. THORSEN,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR THE WRIT OF CERTIORARI.

I.

THE OPINIONS OF THE COURTS BELOW.

The opinion of the Circuit Court of Appeals for the Ninth Circuit was rendered on May 19, 1933. (R. 83.) It has not yet been officially reported. A copy of the opinion is reprinted in the record at page 84. The findings of fact, opinion and decision of the Board of Tax Appeals were filed on October 21, 1931, and are reported in 24 B. T. A. 480.

II.

JURISDICTION.

1. The statutory provision believed to sustain jurisdiction is Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

2. The date of the judgment to be reviewed is May 19, 1933. (R. 83.) No petition for rehearing was filed. An order was entered on May 25, 1933, by the Circuit Court of Appeals of the Ninth Circuit staying the mandate, pending this application. (R. 96.)

3. The nature of the case is stated under the heading "A" in the petition, and therefore is not here repeated.

4. The jurisdiction is believed to be sustained by *Gulf Oil Corporation* v. *Llewellyn,* 248 U. S. 71; 63 L. Ed. 133; 39 S. Ct. 35; *Old Colony Railroad Company* v. *Commissioner of Internal Revenue,* 284 U. S. 552; 76 L. Ed. 484; 52 S. Ct. 211; and *Aiken* v. *Burnet,* 282 U. S. 277; 75 L. Ed. 339; 51 S. Ct. 148.

III.

STATEMENT OF THE CASE.

A full statement of the case has been given under the heading "A" in the petition and hence is not here repeated.

IV.

SPECIFICATIONS OF ERRORS.

The errors of the Circuit Court of Appeals for the Ninth Circuit to be urged are:

1. It erred in finding that any deficiency existed with respect to the income taxes of Thorsen for the calendar year 1923.

2. It erred in not finding that Thorsen is entitled to a refund of income taxes overpaid by him for the calendar year 1923.

3. It erred in so interpreting the provisions of Section 201 of the Internal Revenue Act of 1921 that the losses of West Side Lumber Company for the years ending February 28, 1915, and February 29, 1916, were not deducted from its total profits of the years March 1, 1916, to April 23, 1923, in computing its "earnings accumulated since February 28, 1913," within the meaning of such section.

4. It erred in not finding that the words "earnings or profits accumulated since February 28, 1913," in Section 201 of the Internal Revenue Act of 1923 mean the net profits of the whole period from March 1, 1913, to the date of the distribution of profits.

5. It erred in finding that the dividend distribution of West Side Lumber Company on April 14, 1923, was 22.75 per cent taxable instead of 14.91 per cent taxable.

V.

ARGUMENT.

A.

Reasons Relied Upon for the Allowance of the Writ.

1. The first reason given in the petition for the allowance of the writ of certiorari is that the decision of the Circuit Court of Appeals in this case is in direct conflict with the decision of the Circuit Court of Appeals of the Second Circuit in the case of *Charles J. Canfield* v. *Commissioner of Internal Revenue* (62 Fed. 2d. 751), and with the opinion and decision of the Circuit Court of Appeals of the Second Circuit in the case of *T. Irving Hadden, Executor,* v. *Commissioner of Internal Revenue* (49 Fed. 2d. 709).

The conflict with the Canfield case is direct and positive. Both cases grew out of the dividend distribution of West Side Lumber Company on April 14, 1923, of $5,100,000. Canfield had 600 shares of stock in that company and received $204,000 of that distribution. Thorsen had 3,270 shares and received $1,111,800. The Commissioner sought to assess deficiencies in each case on the theory that the losses of West Side Lumber Company for the years ending February 28, 1915 ($193,139.67) and February 29, 1916 ($211,707.32) should not be deducted from its aggregate profits of the years from March 1, 1916, to April 14, 1923, in determining the taxable proportion of such distribution, and that they should, instead, be regarded as a dissipation of the surplus of that company of March 1, 1913.

There is absolutely no difference whatever in the two cases beyond the difference in the number of shares owned by the two men and hence in the number of dollars received by each in the distribution. One happens to live in the Seventh Circuit and one in the Ninth Circuit. The Canfield half of the decision of the Board of Tax Appeals has been reversed and the Thorsen half affirmed. One or the other court is of necessity wrong.

The Commissioner has filed in this court his petition for certiorari in the Canfield case. Both cases therefore are here pending upon identical applications.

Not alone is there this conflict with the Canfield case, but the present decision likewise conflicts with the decision of the Circuit Court of Appeals of the Second Circuit in the Hadden case. The court in that case had under consideration the corresponding section of the Act of 1916, construed it and announced the following principle:

> "The accumulated profits since March 1, 1913, must necessarily mean the net excess of all profits between March 1, 1913, and the date of distribution, less all losses sustained between the same dates."

This is the principle for which Thorsen here contends. The Hadden case is, we submit, a direct decision on the question at issue herein and is adverse to that of the Circuit Court of Appeals of the Ninth Circuit. It therefore appears that the present decision is in conflict with decisions in the Second and the Ninth Circuits. Without question, it is in square conflict with the decision of the Circuit Court of Appeals of the Seventh Circuit in the Canfield case.

2. The second reason relied upon for granting

certiorari is that the present case decides an important question of federal law which has not been, but should be, settled by this court.

Paragraph (a) of Section 201 of the 1921 Act first appeared (in substantially the same form) as Section 2 (a) of the 1916 Act. Paragraph (b) first appeared, (in somewhat different form) as Section 31 (c) of the Act of 1917. The two were combined in the Act of 1918 as Section 201 and have been reenacted in the 1921, 1924, 1926, 1928 and 1932 Acts (with certain amendments from time to time to meet certain other changes in the various acts).

The issue in this case can readily arise under all these acts and has repeatedly arisen, as is shown by the Hadden, Canfield, Thorsen and Walker cases. That a large number of similar cases are pending before the Bureau of Internal Revenue is asserted in the petition of the Commissioner for certiorari in the Canfield case.

The Board of Tax Appeals having now held definitely against the contention of the Commissioner, it would appear that confusion must persist upon this question until this court has settled it. Apparently, the Commissioner will continue to assess deficiencies upon his theory. Upon appeal, the Board of Tax Appeals will, it would seem, continue to hold adversely to the Commissioner, who will therefore be driven to proceedings to review such decisions of the Board in the several circuits. This case therefore involves an unusually important question of federal law which has not been, but should be, decided by this court.

3. The third reason relied upon is that the Circuit Court of Appeals has herein decided a federal

question in a way probably in conflict with applicable decisions of this court.

In *Southern Pacific Co.* v. *Lowe* (247 U. S. 330; 62 L. Ed. 1142; 38 S. Ct. 540) Mr. Justice Pitney said:

> "This being so, we are bound to consider accumulations that accrued to a corporation prior to January 1, 1913, as being *capital, not income, for the purposes of the act.*" (Italics supplied.)

Statements and decisions of like or similar character have been made by this court in *Gulf Oil Corporation* v. *Lewellyn* (248 U. S. 71; 63 L. Ed. 133; 39 S. Ct. 35), *Eisner* v. *Macomber* (252 U. S. 189; 64 L. Ed. 521; 40 S. Ct. 189), *Lucas* v. *Alexander* (279 U. S. 573; 73 L. Ed. 851; 49 S. Ct. 426) and *Old Colony Railroad Company* v. *Commissioner*, (284 U. S. 552; 76 L. Ed. 484; 52 S. Ct. 211).

It has been urged in the present case and the other pending cases that under these decisions a corporate surplus of March 1, 1913, has been made capital by the several acts, with the ordinary attributes of capital. Treasury rulings admit that when original capital is depleted it may be replaced from later earnings and then distributed tax-free to the recipient. The Commissioner denies the right of replacement as to such of the capital of March 1, 1913, as was not paid-in capital. There appears to be no basis for such different treatment of earned capital (as of March 1, 1913) and original paid-in capital. Hence, the Circuit Court of the Ninth Circuit, having denied the attributes of capital to the surplus of March 1, 1913, has decided a federal question in a way probably in conflict with applicable decisions of this court.

B.

The Point Involved.

The question involved in this case is the interpretation of that portion of Section 201 (a) of the Revenue Act of 1921 providing for the taxation of dividends and taxing "any distribution made by a corporation to its shareholders or members * * * out of its earnings or profits accumulated since February 28, 1913." Dividends would not be taxable unless Congress made them so. This provision, defining what dividends only should be taxed, namely, those declared out of "earnings or profits accumulated since February 28, 1913," is the only authority for taxing dividends at all. After such earnings and profits have been distributed, the earnings and profits accumulated prior to March 1, 1913, may be distributed tax free.

It is the position of the petitioner that:

(1) The date of March 1, 1913, was the ending of one period and the beginning of another,* and that the two are wholly distinct, each with its own surplus or deficit as the case may be;

(2) The tax is levied only upon the profits accumulated in a specified period, *as such,* and hence *the entire period,* and not the several years composing the period, is the unit of computation;

(3) This being so, to arrive at the taxable accumulations of the period, the aggregate of all losses of the several loss years of the period must be sub-

*In *Lucas* v. *Alexander,* 279 U. S. 573, 73 L. Ed. 851; 49 S. Ct. 426, this court spoke of the "periods before and after March 1, 1913."

tracted from the aggregate of all profits of the several profit years of the period. The difference is the net earnings or profits of the period, and this alone is made taxable on distribution, by the Act of 1921—otherwise, in effect, the words "profits accumulated since February 28, 1921" are stricken from the act.

(4) This mode of computation leaves, of necessity, the surplus of March 1, 1913, intact, and it may then be distributed tax free;

(5) The foregoing approach to the problem exactly co-ordinates with the result arrived at by considering the nature of the surplus of the first period;

(6) This court has repeatedly* spoken of the surplus of March 1, 1913, as "capital for the purposes of the Act." Capital is not taxable upon distribution. If it be temporarily impaired, it may always be replaced from subsequent earnings. Upon replacement, it is then distributable, as before, tax free. This mode of approach arrives at the same result as that reached by interpreting the words "accumulated since February 28, 1913"—that the only taxable distribution is that of the net of the second period;

(7) The Act of 1921 therefore taxed to the recipient Thorsen only his share of the net of the period "since February 28, 1913," and left inviolate for distribution to him his share of the surplus of March 1, 1913—made *"capital, not income, for the purposes of the act."*

**Southern Pacific Co* v. *Lowe*, 247 U. S. 330, 62 L. Ed. 1142, 38 S. Ct. 540; *Gulf Oil Corporation* v. *Lewellyn*, 248 U. S. 71, 63 L. Ed. 133, 39 S. Ct. 35; *Lucas* v. *Alexander*, 279 U. S. 573, 73 L. Ed. 851, 49 S. Ct. 426; *Old Colony Railroad Company* v. *Commissioner*, 284 U. S. 552, 76 L. Ed. 484, 52 S. Ct. 211.

C.

The Opinion in the Thorsen Case in the Circuit Court of Appeals of the Ninth Circuit.

1. The court below said (R. 89):

> "We are here concerned with the extent of the exemption conferred by the Act of 1921."

It several times refers to the right to distribute the March 1, 1913, surplus, tax free, as an "exemption." In so doing, it adopts the language of the Commissioner, who claimed that there was a burden upon the petitioner to bring himself within an exempting clause. Clearly this is an erroneous approach to the problem.

No tax can be levied without legislative authority. There is no authority anywhere in the act to tax any dividend, excepting the authority contained in paragraph (a). This is strictly a paragraph of *definition,* and not of exemption. It defines the only kind of dividend taxable under the act, namely, one paid out of "earnings or profits accumulated since February 28, 1913." The burden must be on the Commissioner to show that the distribution here sought to be taxed is a dividend paid "out of earnings or profits accumulated since February 28, 1913," for this is the only kind of dividend he can reach. All others are simply untaxed and the burden is on him to show his authority to tax. No such authority will be presumed. This erroneous position of the court has colored its entire opinion.

2. The court (R. 90) makes the statement that Thorsen's position "ignores both bookkeeping and reality." To the contrary, proper accounting procedure would call for the development of a separate

profit and loss account for the period beginning March 1, 1913, inasmuch as the accumulations of that period are taxable and the accumulations of the prior period are distributable tax free, and have become "capital for the purposes of the act."

Nor does the argument of Thorsen "ignore reality." There is nothing in the record to show that West Side Lumber Company could in fact have distributed instanter $4,332,684.78 of its total assets of $5,833,684.78. This would have required a 74 per cent liquid position—one scarcely to be anticipated for any corporation, and in particular not for a lumber company, with its capital necessarily largely invested in fixed assets. It would be an unreasonable interpretation to require instant liquidation in order to take advantage of the tax-free provision, for Congress did not anticipate the liquidation, but the continuance of corporate enterprises.

This is the more obvious from the fact that the Act *in 1921* provided that the *March 1, 1913,* surplus might *then* be distributed tax free. Why should temporary fluctuations in position in 1915 and 1916 be deemed to have been important, when Congress in 1921 recognized the whole March 1, 1913, surplus, after the lapse of eight years, to be *then* distributable without tax? Thorsen's position accords with reality and the opinion of the lower court ignores it.

3. The court expresses the view that March 1, 1913, surplus must be deemed hazarded in the business and forever dissipated if temporarily drawn on, because there is no express provision in the act for its replacement. There is no express provision in the act for the replacement of paid-in capital, but even the court below recognizes that paid-in capital, though also hazarded and drawn on, may be re-

placed. No express provision is necessary. If, as this court has said, March 1, 1913, surplus is "capital *for the purposes of the act,*" it has, it would seem, this attribute of capital in questions arising under the act. There is no reason why it should be differentiated from paid-in capital for the purposes of the act. The fact that in the year 1921 Congress specifically said that the surplus of *March 1, 1913,* was *then* distributable tax free, confirms the view that the tax-free distribution is a constant and not a variable. Indeed, all the acts, including that of 1932, continue to recognize March 1, 1913, surplus, as such, and even to-day give the right to distribute it tax free.

4. The court below omits discussion of the heart of the case, namely, the words *"profits accumulated since February 28, 1913."* Without reference to the question of capital replacement, these words require the conclusions urged by the petitioner. Whether losses of 1915 and 1916 shall be charged against surplus or entered as deficit items in a new profit and loss account, is a matter merely of bookkeeping. Conclusions should not flow out of mere matters of accountancy. It is the act that is to be interpreted. The plan of Congress would seem self-evident, namely, to create two independent periods (1) that antedating income taxation and (2) that subject to such taxation. Whatever had been earned was to be distributed free from tax; that which was to be earned was to be taxed on distribution. The net of the first period was to be free from tax and the net of the second period was to be taxed. The case is as simple as that. Any other view flows out of a bookkeeping concept of the statute. The court below failed to discuss the intent of Congress and

the meaning of the clause, *"accumulated since February 28, 1913."*

The petitioner therefore prays that the writ of certiorari may issue to the Circuit Court of Appeals of the Ninth Circuit to review its decision herein.

EDWIN H. CASSELS,
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BARRY GILBERT,
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